



DEPARTMENT OF THE ARMY
UNITED STATES ARMY LEGAL SERVICES AGENCY
901 NORTH STUART STREET
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January 11, 2005

REPLY TO
ATTENTION OF
Regulatory Law Office
U 4102

ORIGINAL

Subject: In The Matter Of Qwest Corporation's Filing Of Renewed Price Regulation Plan.
Arizona Corporation Commission, Docket No. T-01051B-03-0454 and In The Matter Of The
Investigation Of The Cost Of Telecommunications Access. Arizona Corporation Commission,
Docket No. T-00000D00-672.

Arizona Corporation Commission
Docket Control
1200 West Washington Street
Phoenix, Arizona 85007

Enclosed for filing with the Arizona Corporation Commission are the original and fifteen copies of the Surrebuttal Testimony of Richard B. Lee on behalf of the Department of Defense and All Other Federal Executive Agencies (DOD/FEA) in the subject proceedings. This Testimony is dated January 12, 2005.

Copies of this Testimony have been served in accordance with the attached Certificate of Service. Inquiries concerning this matter may be directed to the undersigned at (703) 696-1644.

Sincerely,

Peter Q. Nyce Jr.
General Attorney
Regulatory Law Office

Enclosure

Arizona Corporation Commission
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JAN 12 2005

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BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner

IN THE MATTER OF QWEST) DOCKET NO. T-01051B-03-0454
CORPORATION'S FILING OF RENEWED)
PRICE REGULATION PLAN)
)
IN THE MATTER OF THE INVESTIGATION) DOCKET NO. T-00000D-00-0672
OF THE COST OF TELECOMMUNICATIONS)
ACCESS)

SURREBUTTAL TESTIMONY

of

RICHARD B. LEE

on behalf of

THE UNITED STATES DEPARTMENT OF DEFENSE

And

ALL OTHER FEDERAL EXECUTIVE AGENCIES

ROBERT N. KITTEL, CHIEF

Regulatory Law Office

Office of the Judge Advocate General

U.S. Army Litigation Center

901 N. Stuart Street, Suite 713

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by

Peter Q. Nyce, Jr.

General Attorney

January 12, 2005

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Richard B. Lee. I am Vice President of the economic consulting firm of Snavely King Majoros O'Connor & Lee, Inc. ("Snavely King"). My business address is 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS DOCKET?

A. I am appearing on behalf of the United States Department of Defense and all other Federal Executive Agencies ("DOD/FEA").

Q. ARE YOU THE SAME RICHARD B. LEE WHO SUBMITTED DIRECT TESTIMONY IN THIS PROCEEDING ON NOVEMBER 18, 2004?

A. Yes, I am.

Q. DID YOUR DIRECT TESTIMONY CONTAIN A DESCRIPTION OF YOUR BACKGROUND AND EXPERIENCE?

A. Yes, it did.

Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR DIRECT SUPERVISION?

A. Yes, it was.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. In this surrebuttal testimony I will respond to the rebuttal testimony of Qwest Corporation ("Qwest") witness David L. Teitzel with respect to his criticisms of my recommendations concerning modifications to Qwest's price cap proposals.

1 **II. SOME BASKET 1 SERVICE PRICING**
2 **LIMITATION IS NECESSARY.**
3

4 **Q. IN YOUR DIRECT TESTIMONY, DID YOU RECOMMEND A LIMIT TO**
5 **QWEST'S SERVICE PRICING FLEXIBILITY IN BASKET 1?**

6 A. Yes, I did. Basket 1 contains basic/essential non-competitive retail services. I
7 recommended that the increase in price for any service in Basket 1 be limited to 10
8 percent in a given year.¹

9 **Q. DID MR. TEITZEL AGREE WITH YOUR RECOMMENDATION?**
10

11 A. No, he did not. Mr. Teitzel stated that my recommendation was not necessary, since
12 "Qwest is not proposing additional pricing flexibility for Basket 1 services in this
13 docket."²

14
15 **Q. DO YOU AGREE WITH MR. TEITZEL THAT QWEST IS NOT PROPOSING**
16 **ADDITIONAL PRICING FLEXIBILITY FOR BASKET 1 SERVICES IN THIS**
17 **DOCKET?**

18 A. No. Qwest has proposed the elimination of two important pricing limitations. First, under
19 the current price cap plan, certain basic services are subject to a "hard cap", meaning that

¹ Lee Direct, at 8.

² Teitzel Rebuttal, at 47.

1 their prices are capped at their initial levels throughout the term of the plan.³ Qwest
2 witness Harry M. Shooshan III states that the hard cap on these services “while serving to
3 protect consumers of these basic services during what amounted to a transition to price
4 regulation, nonetheless has severely limited Qwest’s ability to adjust its overall pricing to
5 reflect market conditions.”⁴ Second, under the current plan, the rates for the remaining
6 services in Basket 1 may increase by no more than 25 percent within a year.⁵

7 Both of these pricing limitations are missing from Qwest’s Revised Cap Plan
8 proposal. Under Qwest’s proposal, any Basket 1 service price can be raised by any
9 amount as long as notice to the Commission is provided and offsetting Basket 1 price
10 reductions are filed simultaneously.⁶ Contrary to Mr. Teitzel’s assertion, the removal of
11 the above pricing limitations represents a very significant increase in pricing flexibility
12 for Qwest.

13 **Q. IN YOUR DIRECT TESTIMONY DID YOU OPPOSE THE ELIMINATION OF**
14 **HARD CAPS ON BASKET 1 SERVICES?**

15 **A.** No, I did not. I believe that, as competition increases for basic/essential services, Qwest
16 should be given the opportunity to adjust its prices to better reflect its costs. For

³ Current Price Cap Plan, at Section 2ci. These services are flat rate residential; flat rate business; 2 & 4 party service; exchange zone increment charges; low use option service; service stations service; telephone assistance programs; individual PBX Trunks including features; Caller ID block; toll blocking; 900/976 blocking; and basic listing service.

⁴ Shooshan Direct, at 7.

⁵ Current Price Cap Plan, at Section 2ciii.

⁶ Revised Price Cap Plan, at 2bi. Non-revenue neutral price increases for Basket 1 services require approval from the Commission (Id., at 2biii).

1 example, Qwest's flat business line rate (\$30.40) is more than twice its current flat
2 residence line rate (\$13.18). In any given locality, however, the costs of providing
3 business and residential lines are essentially the same. Qwest's Unbundled Network
4 Element ("UNE") loop rates do not differentiate by business or residence, only by cost
5 zone.⁷ I believe the new price cap plan should provide Qwest with the opportunity to
6 begin correcting pricing anomalies such as this.

7 **Q. WHY DID YOU RECOMMEND THAT THE INCREASE IN PRICE IN ANY**
8 **SERVICE IN BASKET 1 BE LIMITED TO 10 PERCENT IN A GIVEN YEAR?**

9 A. As I stated in my direct testimony, I am concerned that sharp price increases for some
10 services could cause "rate shock" to individual customers.⁸ My proposed limitation will
11 allow Qwest's customers the opportunity to adjust to changing price levels as Qwest
12 brings its prices in line with its costs.

13
14 **III. COMPETITIVE ZONES SHOULD BE ESTABLISHED ONLY**
15 **WHERE EFFECTIVE COMPETITION IS ENTRENCHED.**
16

17 **Q. IN YOUR DIRECT TESTIMONY, DID YOU RECOMMEND CONDITIONS**
18 **WITH RESPECT TO THE DETERMINATION OF "COMPEITIVE ZONES"**
19 **WHICH WOULD ALLOW THE TRANSFER OF BASIC/ENHANCED**
20 **SERVICES FROM BASKET 1 TO BASKET 3?**

⁷ Teitzel Direct, at 36. The rates are \$9.05 in Zone 1, \$14.84 in Zone 2, and \$36.44 in Zone 3.

⁸ Lee Direct, at 8.

1 A. Yes, I did. Basket 3 contains flexibly-priced competitive retail services. I recommended
2 that the transfer of basic essential services to Basket 3 only be approved when there is
3 clear evidence of permanent, effective competition in the zone under consideration.⁹ I
4 recommended that such a transfer only be approved when one or more facilities-based
5 competitors can be shown to be offering service throughout the zone and actually
6 providing service to a significant number of customers.¹⁰

7 **Q. DID MR. TEITZEL AGREE WITH YOUR RECOMMENDATION?**

8 A. No. Mr. Teitzel stated that he believed my “view of the competitive telecommunications
9 market is far too narrow and does not account for telecommunications alternatives
10 Arizona customers are using today.”¹¹

11 **Q. HOW DO YOU RESPOND TO MR. TEITZEL’S CRITICISM?**

12
13 A. In my direct testimony, I stated that UNE-based and resale competitive local exchange
14 carriers (“CLECs”) should not be considered in the determination of competitive zone
15 eligibility because of their dependence on Qwest and their relatively little capital
16 investment in a zone.¹² Full facilities-based competitors, on the other hand, operate
17 independently from Qwest and have committed significant capital to their ventures.
18 Indeed, once telecommunications facilities are in place, they are likely to continue in

⁹ Id., at 8-9.

¹⁰ Id.

¹¹ Teitzel Rebuttal, at 48-49.

¹² Lee Direct, at 9.

1 service by some CLEC even if the CLEC originally placing them fails. Full facilities-
2 based competition can be considered “entrenched,” a term Mr. Teitzel uses, meaning
3 “fixed firmly or securely.”¹³

4 In marked contrast, CLECs dependent upon UNEs or resale will always be
5 subject to possible price squeezes and the turning tides of regulation. Competition from
6 such CLECs can justify a degree of increased pricing flexibility for Qwest, but is not
7 sufficient to justify competitive zone approval.

8 Similarly, both wireless and Voice-over-Internet-Protocol (“VoIP”) services
9 impact (or may impact) the market for basic local services, but neither should be the basis
10 for competitive zone determination. Wireless services, while ubiquitous, provide a viable
11 substitute for basic local services for only a limited segment of the market. VoIP is
12 dependent upon a broadband connection which may, or may not, be provided by Qwest.
13 Whether or not Qwest provides the facilities used by VoIP is relevant to the
14 determination of competitive zones. The use of the internet protocol, in itself, is not
15 relevant to the determination of competitive zones.

¹³ Teitzel Rebuttal, at 50. American Heritage Dictionary of the English Language, 1979, at 437.

1 **IV. COMPETITIVE ZONES SHOULD BE ESTABLISHED SEPARATELY**
2 **FOR RESIDENTIAL AND BUSINESS SERVICES.**

3
4 **Q. IN YOUR DIRECT TESTIMONY, DID YOU ALSO RECOMMEND THAT**
5 **COMPETITIVE ZONES BE ESTABLISHED SEPARATELY FOR BUSINESS**
6 **AND RESIDENCE SERVICES?**

7 A. Yes, I did.¹⁴

8 **Q. DID MR. TEITZEL AGREE WITH YOUR RECOMMENDATION?**

9 A. No. He states that "once the Commission determines that local exchange competition is
10 entrenched in a defined geographic area in Phoenix and Tucson and that pricing
11 flexibility is appropriate for Qwest in that area, it is unnecessary and cumbersome to
12 define areas as separate residential and/or business competitive zones."¹⁵

13 **Q. HOW DO YOU RESPOND TO MR. TEITZEL?**

14 A. I believe the establishment of competitive zones is a serious step because it allows the
15 transfer of basic/enhanced services from Basket 1 to Basket 3. Whether "cumbersome"
16 or not, I believe the separate determination of competitive zones for business and
17 residence is necessary. Staff witness Matthew Rowell agrees, and states:

18 Staff believes that the business and residential markets for
19 telecommunications services are fundamentally different.

20 Competitive conditions in the markets may be quite

¹⁴ Lee Direct, at 9.

¹⁵ Teitzel Rebuttal, at 49-50.

1 different.¹⁶

2 Residential Utility Consumer Office ("RUCO") witness Ben Johnson, similarly called for
3 data concerning general business and residence market conditions.¹⁷

4 As I explained in my direct testimony, the combining of residential and business
5 data in competitive zone determinations would undoubtedly result in the transfer of
6 basic/essential business services to Basket 3 when effective competition exists for only
7 residence services, and vice versa.¹⁸ For example, Cox Communications ("Cox"), a full
8 facilities-based cable TV company, is providing local service competition in many
9 localities by bundling telephony with its cable TV and internet services. While this
10 approach may have resulted in effective local service competition in the residence market
11 in some localities, it may not have had a significant impact on the business market.
12 Conversely, one or more facilities-based CLECs may have placed fiber rings in urban
13 areas which have resulted in effective local service competition in the business market.
14 For economic or policy reasons, however, these carriers may not have had a significant
15 impact on the residential market.

16 The determination of competitive zones is too serious a matter to be left to the
17 mere assumption that competition is equally effective in both the residential and business
18 markets in every examined zone. The Commission should insist that reliable statistics be

¹⁶ Rowell Direct, at 42.

¹⁷ Johnson Direct, at 171.

¹⁸ Lee Direct, at 9.

obtained to make a credible determination of competitive zones for business and residence services separately.

V. CONCLUSION

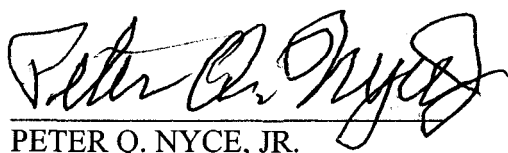
Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Surrebuttal Testimony of Richard B. Lee on behalf of the United States Department of Defense and All Other Federal Executive Agencies was sent to the parties on the attached service list either by United Parcel Service - Next Day Air, or by first class mail, postage prepaid on January 11, 2005.

Dated at Arlington County, Virginia, on this 11th Day of January 2005.


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